

THE PROPOSED MERGER OF TABCORP HOLDINGS LTD AND TATTERSALLS LTD

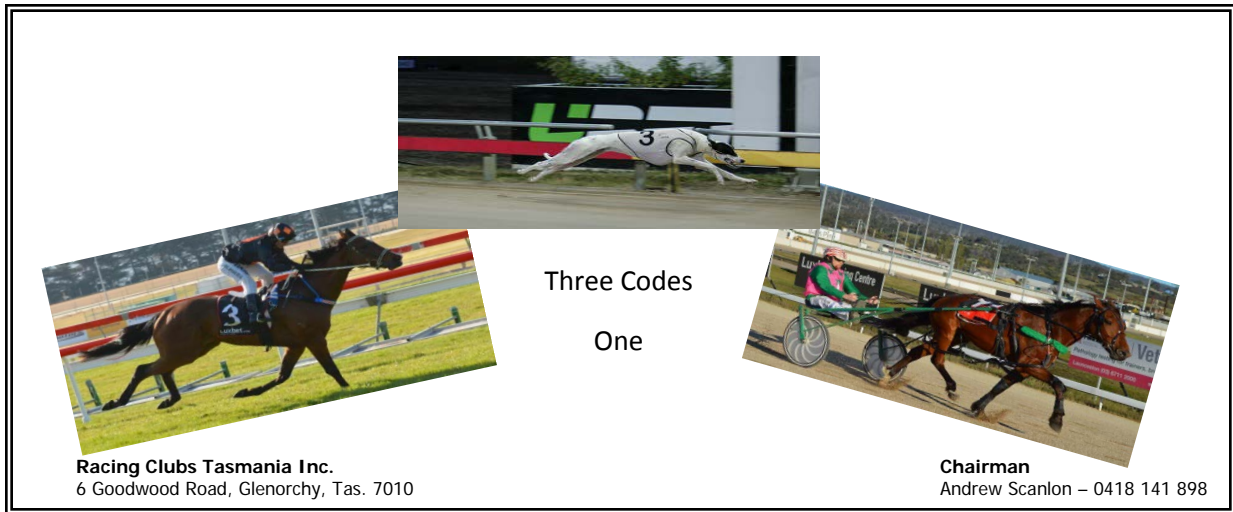
SUBMISSION BY RACING CLUBS TASMANIA

12 April, 2017

Racing Clubs Tasmania Inc.

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SUBMISSION BY RACING CLUBS TASMANIA - ACT 1 2017 – TABCORP HOLDINGS MERGER WITH TATTERSALLS LTD.

BACKGROUND

RACING CLUBS TASMANIA Inc. (RCT) has been established by the major racing clubs in Tasmania and as such it represents a key segment of the value chain for the Tasmanian racing industry. Racing clubs are the key organisations who stage the race meetings in all three codes of racing. Accordingly any change to the competition landscape for wagering will impact on the market for the production and sale of the racing product and affect the financial capacity of the Tasmanian racing industry. The creation of a monopoly in the market for pari mutuel wagering has the potential to impact negatively on stakesmoney paid to racing participants and or the ability of the clubs to attract patrons to the racing events they present and this of concern to RCT.

Accordingly RCT provides the following comments after reviewing a number of the submissions that have been made to the Australian Competition Tribunal (ACT), including the Issues Statement submitted by the ACCC. These comments are intended to draw the ACT's attention to the key issues for the Tasmanian racing industry that arise from the proposed merger should it be authorised to take place.

In this respect RCT notes with disappointment that the peak racing authority (PRA) for Tasmania, Tasracing had not, at the time of writing, made a submission to either the ACCC or the ACT to put forward the views of the participants in the Tasmanian racing industry about the concerns its members have with the merger taking place. Equally, RCT is disappointed that the government of Tasmania did not see fit to intervene on behalf of the Tasmanian racing industry to protect the interests of its stakeholders and participants particularly since it provides the majority of funding to the industry and therefore has a clear interest in ensuring that Racefields Fees continue to grow to keep the pressure off funding from the state's budget.

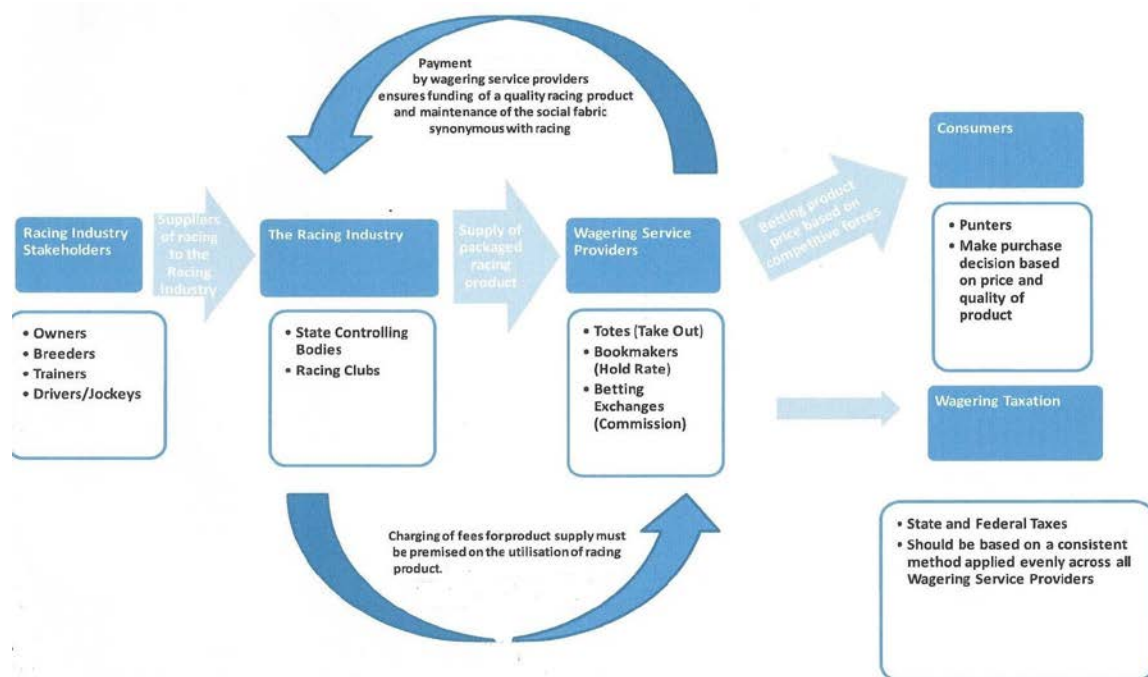
It is in this context that RCT seeks the indulgence of the ACT to review the information provided below and the two documents attached hereto which were submitted to the ACCC.

VALUE CHAIN

It is of deep concern to RCT that in reviewing the submissions which support the merger and the list of issues contained in the Issues Statement lodged by the ACCC that invariably, they adopt a simplistic view of the funding structure of the racing industry. The assumption that the structure in each state is the same is not correct. Importantly, the submissions treat the consumers of the racing product, punters, as a homogenous group which is not also the case. Finally, the submissions indicate incorrectly that the products in the wagering market are perfect substitutes and that there exists no separate market for pari mutuel wagering products.

These fundamental mistakes by those that support the merger and the ACCC have biased their submissions towards the conclusion that the merger is inevitable. In doing so, the focus of the discussion is largely about the impact of the merger on consumers only thereby basically underplaying the key segments of the value chain which produce the wagering product.

To address this conclusion the following schematic illustrates the critical role of the owners, breeders, trainers, jockeys and drivers AND the racing clubs in what is a vertically integrated industry. It indicates where the critical decisions are made with respect to the financial sustainability of these segments through the flow of funding of the entire racing industry.



Accordingly the RCT is arguing that the ACT must take a wider view and consider the impact of the merger on the production and sale of wagering product to the wagering operators in addition to the packaging and sale of that product by the wagering operators to the eventual consumers, the punters. This focus demands that the role of Sky Channel be evaluated with respect to how it enhances the market power of Tabcorp if it becomes a monopoly pari mutuel wagering operator.

To this end the role of Sky Channel is one of an intermediary that has caused the decomposition of the value chain through its ability to determine the time slots in which the wagering product is transmitted to the punters. Through this market power it has the capacity to usurp the role of the racing clubs and PRA's who are responsible for presenting the racing programme. To this end Attachment A to this document provides examples of the impact of this on the racing industry in Tasmania. This information reinforces the view that Sky Channel and a monopoly pari mutuel wagering operator together would continue to create market conditions that detract from the public benefits of the merger particularly for a small state such as Tasmania.

Finally, consistent with the earlier comment that many of the submissions, and that by the ACCC, appear to regard that it is a foregone conclusion that the ACT will sanction the merger, RCT is informed that the management of Tattersalls has already formally advised its workforce in writing that individuals should start looking for new employment opportunities. This is an arrogant treatment of the ACT's role, suggesting that its deliberations are little more than "window dressing".

Accordingly there are three areas where RCT requests the ACT examine the market detriment of creating a monopoly in pari mutuel wagering to be offset by the public benefits of the merger of Tabcorp and Tattersalls. In this regard no substantial public benefits have as yet been identified as likely to occur in Tasmania.

These areas are;

- The impact on Racefields Fees potentially earned by the Tasmanian racing industry
- The erosion of the capacity of the Tasmanian government to determine the relevant return to consumers through the adjustment of the take-out rates for pari mutuel products and to reintroduce taxation on wagering
- The failure to recognise the proper characteristics of the pari mutuel market and removal of the capacity for consumers to take advantage of the benefits that differentiate the product offer of both the existing wagering operators

RACEFIELDS FEES

The submissions examined by RCT reveal a fundamental error in that they assume the relationship between the licensed pari mutuel wagering operator and the racing industry in each state is the same. That is they assume there is a direct funding relationship from the TAB to the racing industry either through a profit sharing arrangement or through a direct financial supplement of the other income raised by the industry. This is not the case in Tasmania nor does it apply in the ACT and the NT. It is the case that all three racing industries are funded from their government's budget.

In this respect the offer of sponsorship arrangements cannot be regarded as an equivalent and permanent financial supplement for a racing club or a PRA as they are driven by market objectives of the sponsor which will change from time to time. This is put into perspective by a former Chairman of the Australian Racing Board who stated "...Prizemoney levels can only be maintained at necessary standards with all wagering operators paying adequate returns, not a "pay what we like" system. Sponsoring races with nickels and dimes is no substitute for the current system of funding that has built the Australian racing industry to its present world prominence. Sponsorship ... is selective and cannot possibly sustain a structured racing program"¹.

RCT considers that if there is only one supplier of pari mutuel wagering product to punters then it is likely to act as a monopsonist. This market power, when coupled with control of Sky Channel, provides a significant threat to the future of the Tasmanian racing industry. This is particularly so given Racefields Fees contribute 24% of the industry's revenue (noting 45% of wagering turnover is generated through the two pari mutuel operators).

RCT believes that when the time comes to negotiate Racefields Fees this will provide Tabcorp with the power to either seek to reduce the level of payment it is making (on the basis it needs to do this to compete with corporate bookmakers), not agree to pay any increase or argue that now, as it has argued publicly before, it needs to have only one agreement with all racing clubs/PRA's across Australia to simplify the administration of its commercial relationships with these bodies. This fee could be set at the lowest common denominator based on that paid in one or more of the states where it has a profit sharing arrangement and where lowering the cost of operations will be reflected in a share of increased profits. For example, it could be based on a fee structure that was negotiated with the NSW racing industry.

The danger of having one organisation setting the Racefields Fees for a given state or changing the formula on the basis of needing to do this to compete with corporate bookmakers (e.g. in the face of declining market share) has been highlighted by Mr Peter V'Landys, CEO of Racing NSW, in commenting on the recommendation for a National approach to setting these fees made by the Productivity Commission in its 2010 report on Gambling.

Mr V'Landys stated "...The two most ridiculous recommendations are that an independent organisation set the price of that racing product. Does that mean every commercial operation in Australia could have its price set by someone other than themselves - which would send them broke? Further it suggests the charge should be based on the wagering operator's gross profit. That means the essential funding to the NSW thoroughbred industry would depend on the business model and risk strategy of wagering operators... The Racefields legislation is commercially analogous to the owner of intellectual property granting non-exclusive licences to a large number of competing operators. This allows each licensee to determine its own strategy, business model and consumer pricing and the intellectual property owner does not become exposed to those issues..." (I.e. their business model, pricing decisions, managing risk or the efficiency of the licensee's operations)².

¹ "ARB chairman calls for long term vision for industry", Thoroughbred News Australia, <http://www.thoroughbrednews.co.nz/australia/default.aspx?id=41502>, accessed 8/07/2009

² Young C, "Bookies and Racing NSW at loggerheads over federal wagering report", Brisbane Times, <http://www.brisbanetimes.com.au/sport/horse-racing/bookies-and-racing-nse-at-logg...> Accessed 26/10/2009 and

Evidence that Tabcorp is prepared to enter into litigation on Racefields Fees is recorded in the legal fight it had with the racing industries in Victoria and in a dispute with the NSW over the level of fees³.

PRICING OF PARI MUTUEL PRODUCTS

The price at which a pari mutuel product is provided to punters is based on the take-out rate set by legislation or regulation by each state government currently harmonised at not greater than an average of 16% across the financial year. This requirement has in the past resulted in the TABs holding “sales” to lower the take-out on a temporary basis to ensure that the overall average take-out does not exceed 16%.

On the basis that if this merger were to proceed there will be no turning back to provide an opportunity for another wagering operator to enter the market in any state but Western Australia (as raised by the submissions to the ACT from Racing Victoria Limited and CrownBet) no individual state could ever decide to implement a lower take-out to attach to its pari mutuel license to increase wagering turnover nor could it force Tabcorp to do this to give a better return on that state’s product (noting the optimum take-out rate is estimated by Windross to be 12%⁴). Thus the punters would be impacted in the national market and the racing industry in those states where there is no profit sharing arrangement and direct funding is provided by the government.

As state wagering taxation is paid out of the take-out then the capacity to adjust this would also be weakened. For example, Tabcorp could oppose any increase in the state wagering taxation, an example being Tasmania where it is currently zero rated. This effectively means that the punters who bet through the Tasmanian licence are directly subsidising the profits of Tatts (currently) a public company whose primary interest is in servicing the needs of its shareholders. This taxation rating was introduced to distribute the revenue otherwise paid to the state treasury directly to the racing industry as stakesmoney, a decision which has been a negative outcome of the sale of TOTE Tasmania and will be perpetuated over the long-term if Tabcorp acquires that licence.

Further achieving control of a national pari mutuel wagering pool has been a long-term objective of Tabcorp. That it has never left any doubt about its objective to achieve this form of control over pari mutuel wagering is confirmed by the then CEO, Mr Funke Kupper, who stated this would benefit both Tabcorp and the racing industry, and “I’d love to have a national pool tomorrow”⁵. This objective has been repeated by the current CEO Mr D Attenborough⁶.

Thoroughbred News Australia, “Racing NSW comments on Productivity Commission report, <http://www.thoroughbrednews.com.au/australia/default.aspx?id=43317>

³ Race Fields Judgement in Favour of Tabcorp, <http://www.racingandsports.com.au> accessed 16/08/09 and “The AJC Should Blame Tabcorp”, <http://www.virtualformguide.com/cgi-bin/tvf/displanewsitem.pl?20090708tab.txt>, accessed 9/07/2009

⁴ Windross A, “Revisiting the Laffer Curve”, unpublished paper, 2009

⁵ Carson V, “Tabcorp chases national dream”, 220 October, 2009, <http://www.smh.com.au/business/tabcorp-chases-national-dream-20091019-518.html>, accessed 21/10/2009

⁶ Excelby N, “Tabcorp-Tatts Group merger touted as solution to ‘re-igniting wagering’ in Queensland, The Courier-Mail, 6 November, 2016

Achievement of this objective would allow Tabcorp to ensure the benefits of the shareholders of the company come first before those of the racing industry as detailed in the following statement made by the Mr E Funke Kupper to the Company's 2009 Annual General Meeting "We have to focus on the businesses we manage, and we are implementing a number of initiatives that will put us in a strategic position to compete, irrespective of the regulatory environment that emerges over the coming years...". The opening of Luxbet was given as an example. These sentiments are supported by the observations of the prominent Australian bookmaker Mr R Waterhouse who stated when commenting on the merger that "...You have to say quite rightly that the Tabcorp Board is only interested in their shareholders and their motive is really the same as the motives of any other firm..."⁷

THE PARI MUTUEL MARKET

Basically all submissions to the ACCC and the ACT which have been reviewed identify the wagering market as one based on products that are regarded as perfect substitutes for each other. The authors also identify consumers (punters or bettors) as a homogeneous group. Individually therefore the assumption is they have plenty of choice as they can substitute a fixed odds product for a pari mutuel product. This is a particularly bad failing with the position taken by the ACCC which has apparently now accepted this as an argument for not adhering to its decision in 2006 to not allow the merger of Tatts with Tabcorp at that time.

The problem with this conclusion by the ACCC and others is that it fails to recognise first that the wagering products differ in terms of the risks faced by the wagering operators in their business models which ultimately determine the odds received by punters. Further punters are not a homogeneous group and they have been profiled as belonging to one of three categories based on the way they select their bets. These are Logical Bettors (25%), Naïve Bettors (64%) and Superstitious Bettors (11%)⁸. Indeed Windross states that the observation "...that all punters are equal...is not the position and consequently flaws are to be seen in the views ... the majority of punters in NSW do not have an account with any of Interstate TABS, Corporate Bookmakers in the Northern Territory or even in NSW, or Betfair⁹.

RCT supports the conclusion that there are punters who are solely interested in wagering in a pari mutuel pool and that they neither understand nor seek to substitute fixed odds products when they bet¹⁰.

⁷ Murdoch S, Gambling, "Waterhouse backs bet merger", The Australian, <http://enews.smedia.com.au/theaustralian/PrintArticle.aspx?doc+NCAUS%2F2017%2...accessed> 5/04/2017

⁸ Windross A J, "The Luck of the Draw Superstition in Gambling", Journal of the National Association for Gambling Studies (Australia), V 15, 1, May 2003, pp. 63-77, and in O'Hara J and Windross A, "Betting on Horse Racing – Is it a VICE?" and which draws on a thesis by Windross "Betting by the Book – A Study of Systems Adopted by Bettors".

⁹ Windross A Submission DR295 to the Productivity Commission Inquiry into Gambling, Productivity Commission 2010, Gambling, Report No. 50, Canberra.

¹⁰ This distinction is made clear in a submission D395 by BETCHOICE.com to the Productivity Commission Inquiry into Gambling, Productivity Commission 2010, Gambling, Report No. 50, Canberra.

Finally, it is not possible to arbitrage a pari mutuel market as the odds obtained on a wager are not determined until after an event is run and the final starting odds published. In this respect RCT notes that some \$6 billion of wagering turnover occurs in these products and hence this is the relevant market the ACT should consider from the perspective of sanctioning a change in the extent of competition in the market.

If there is only one pari mutuel pool operator then the following will occur. Corporate Bookmakers who lay off bets into the pari mutuel pools will have no market power to negotiate a rebate for that business as occurs now (variously identified as 6% and 7%); professional or large scale punters that currently benefit from rebates (e.g. of 2% or more) will have no power to negotiate on this financial benefit. To the extent that this occurs those that cannot return a profit on their business will leave the market, perhaps to bet with overseas pools; to the extent that professional or large punters are able to retain the rebates they currently enjoy, if there is only one pool, and or larger pools on less attractive races, then, because of their business models, they will impact on the returns available to the smaller punters¹¹.

Finally, the average wager in a pari mutuel pool is a mere \$10 and the mode wager is less than this amount¹². Accordingly, even if it were possible, there is little or no reason for the large majority of punters to seek to arbitrage the pari mutuel pools on the basis of the increased returns noting even if they did take this action that the final dividend, and hence the financial return, is not known until the event is run. As noted earlier, Windross has identified that the majority of punters do not have accounts with the TABs outside of their home state.

RCT is not aware of any research or published data that provides conclusive evidence that for individual pools on races that attract a large number of bets that the incremental increase from a merged pool per se will materially benefit punters. Nor is it aware that it would have this impact on the currently lower quality races. Indeed pool variation in terms of odds on offer is because of the quality of the fields, the time the races are run and the number of runners in those races. Races require a minimum of eight runners (ideally 10 to 12) to maximise wagering. To the extent that the merger impacts the revenue to the racing industry in Tasmania these conditions would not be met.

However, pari mutuel punters can take advantage of a range of benefits that the two pari mutuel operators offer over and above the pool odds they offer to win and retain this business. For example, loyalty programmes. This is the key way in which competition manifests itself in this market where the products offered are direct substitutes for each other. Accordingly if the merger proceeds then Tabcorp has less incentive to offer these benefits to the large number of pari mutuel punters. Indeed, it could reduce or withdraw them entirely in the interests of maximising its profits for its shareholders and those states where it has a profit sharing arrangement.

¹¹ Windross A, "Logic or Luck? – Some Gamblers do Win!", *Gambling Research: Journal of National Association for Gambling Studies (Australia)*, v 17, 2 2005 pp. 48-57.

¹² Windross A, Submission DR 295 DR

OTHER MATTERS –PUBLIC BENEFITS TEST

The argument that Tabcorp needs to merge with Tattersalls wagering business to ensure it remains competitive in the wagering market appears to be inconsistent with the competitive stance it currently enjoys. That is, Tabcorp already offers fixed odds wagering products and the combined business in this segment of the market of the two TABs has grown at a faster rate than that of the corporate bookmakers. That is to address this competition the TABs have established fixed odds wagering businesses and the rapid growth in market share is testament to their success in this market (turnover of \$3.509 billion 2015/16 from \$707.7 million in 2005/06)¹³. Further they have the pricing capacity to combat this competition by lowering the take-out rate on pari mutuel wagering (as they do with the so called “sales” referred to above) but have not done so when this would increase consumer surplus for punters and increase revenue for the racing industry.

It should not be the role of the ACT, or the ACCC, to sanction the creation of a market which provides a monopoly power to protect the commercial viability of any company’s business model unless there are significant public benefits that offset the potential for anti-competitive behaviour that this would create. As noted as in other submissions to the ACT once this merger occurs there will be no turning back for the long-term as there will be no capacity for another pari mutuel wagering operator to enter the market when any state or territory license comes up for renewal.

RCT understands that Tabcorp has identified the public benefit of the merger to the entire Australian racing industry as \$50 million a year. However, in discussions with a representative of Tabcorp, RCT was advised, and this was repeated at a public presentation in Launceston, that this was an estimate only. That is, it is not a guaranteed figure and even if it were provided at this level in year one there is no guarantee it will continue to be funded at this level in the very long-term.

Second, RCT has been informed that in discussions with the Australian Trainers Association (which supports the merger) that a document exists to provide for the \$50 million be shared between the racing industries of NSW and Victoria receiving \$15 million each and Queensland (which supports the merger based on a recently agreed “Deed of Understanding with Tabcorp) and South Australia each receiving \$10 million.

RCT concludes therefore there is no share of the \$50 million to flow to the Tasmanian racing industry. This means that if there are any public benefits to Tasmania then they could only come from enhanced wagering through the terrestrial outlets, a declining area of the business. Mr Freeman of Tabcorp has confirmed to a representative of RCT these benefits would be minimal for Tasmania and accrued over the long-term. As noted earlier, employees of U-Bet have been advised by Tattersalls to look for work outside of the merged business. This suggests that there will be job losses to impact on the Tasmanian economy.

¹³ Australian Racing Fact Book, 2015/16, Table 82

These negatives for the Tasmanian racing industry and the state's economy would be on top of the decreased capacity of the industry to maintain, let alone increase, the revenue it gets from Racefields Fees. Also it would mean that a future state government could never adjust the take-out rates on pari mutuel products, e.g. to reintroduce wagering taxation. It would also be unlikely to ever issue a licence to another wagering operator to offer pari mutuel products in the state.

Should the merger result in Racefields Fees being reduced on Tasmanian racing there would be two outcomes for the participants in the racing industry. First, the number of races would be reduced and, second, the quality of horses and greyhounds would be reduced. These results would further reduce the attractiveness to punters of the Tasmanian racing product and result in a further reduction in these fees thereby compounding the above problems.

That these outcomes are a real threat to the industry is encapsulated in advice to RCT of the views on the merger of one of the major thoroughbred clubs in Tasmania. The club has identified that these outcomes would come on top of successive governments in Tasmania reneging on funding obligations as a result of which the industry is falling further behind that in other states in terms of prizemoney on offer (the key driver of the racing industry). It notes that with fewer races now being held and fewer horses and industry participants there is a concern that if this is not addressed Tasmanian based participants will have little choice but to move interstate. This will impact on the capacity of the industry to produce quality horses and jockeys and reduce further the contribution to the State's economy of an important industry.

CONCLUSION

RCT requests that the ACT take into account the particular circumstances faced by the Tasmanian racing industry as a producer of wagering product through a vertically integrated industry as detailed in this document and the attachments. In doing so it respectfully asks that to minimise any negative impact on the Tasmanian racing industry if the merger is to proceed that Tabcorp should be required to enter into negotiations with representatives of the Tasmanian racing industry and the Tasmanian government to introduce a direct financial relationship with the industry to ensure its long-term financial sustainability over and above any sponsorship arrangement. This is considered necessary to ensure that the merger results in a significant and permanent public benefit for the State's economy as it appears will be the case in those states where it has a direct financial commitment to the industry.